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DOW THEORY LETTERS, INC.

"The Market as Interpreted under the Dow Theory"

RICHARD RUSSELL
P. O. Box 15196
San Diego 15, California

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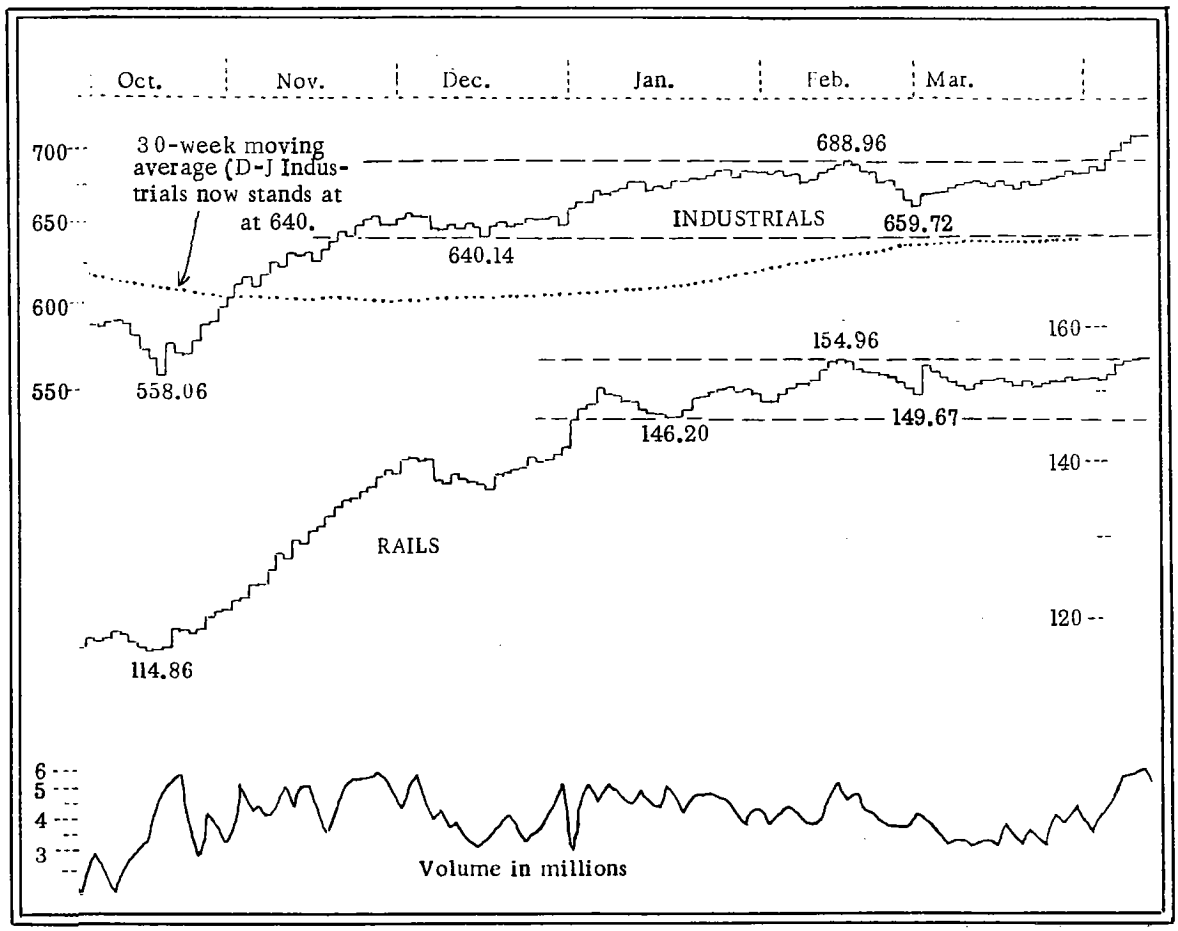
THE MARKET On April 3, Industrials hurdled their preceding (February) recovery high of 688.96. In so doing, the senior Average pushed above the upper limit of its long "line" formation (see chart). April 4 saw a continuation of the rally, and on April 5, Industrials broke above the "700 level" while Rails and the advance-decline ratio also confirmed by rising above all preceding recovery levels. The advance resumed this week with the Averages pushing up Monday and Tuesday. Heavy volume accompanied the surging upward movement last week and early this week.

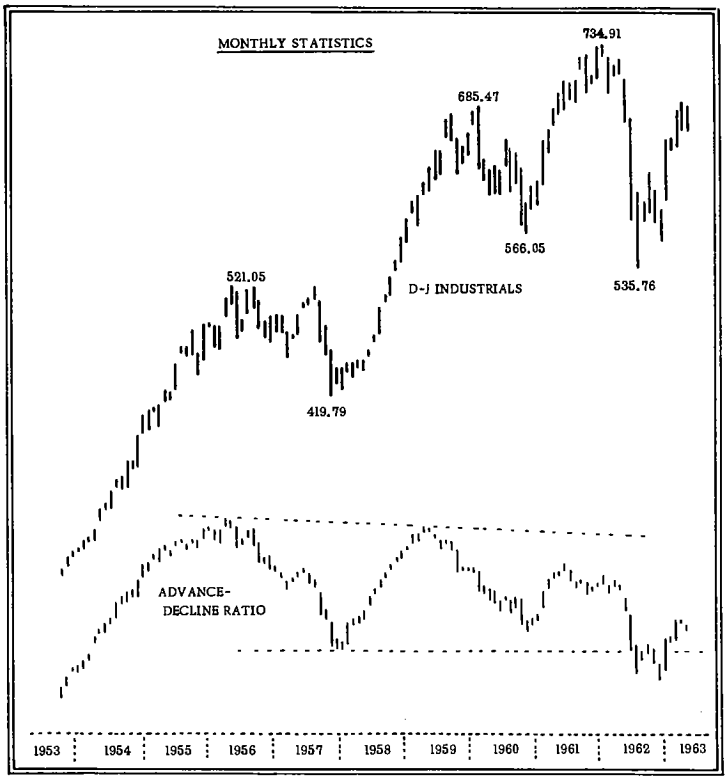
On a cold reading of the price movement taken together with volume, the market appears exceptionally strong. After fluctuating within a long and frustrating "line" area for almost five months, both Dow Jones components have pushed out of their line area on heavy volume. The joint hurdling of the line area suggests that for a number of months stocks have been moving from weak hands to strong hands. Last week the "floating supply" of available stocks was finally exhausted -- with the result that the three price indicators (Industrials, Rails, A-D ratio) rose to new 1963 recovery highs.

Every type of rationale has been advanced to explain the strength of the market. One hears that: (1) Leading corporations have automated, slashed expenses, and are now in a position to reap higher profits. (2) Dollars are bulging in the banks, and these dollars demand an outlet. It is the sheer force of these pent-up funds that has been driving the market higher. (3) The Kennedy Administration is "hell-bent" on winning the 1964 election; and inflation via whopping deficits, mangled budgets and perhaps devaluation is not going to stop them. (I have even heard rumors that "Washington has told Wall Street to hang on or to buy stocks -- something is in the wind!").

A LONG-TERM PICTURE

The chart on page 2 portrays the monthly high and low of the D-J Industrial Average and the monthly high and low of the advance-decline ratio from 1953 to the present. The chart shows a peak registered by the advance-decline ratio in 1956, a second lower peak in 1959 and a third still lower peak in 1961. Against this we see the pattern of a 1959 Industrial high considerably above the 1956 peak and a 1961 all-time high above the 1959 high. Thus an amazing long-term divergence has been set up between the Industrial Average and the mass of stocks on the Board as measured by the advance-decline ratio.



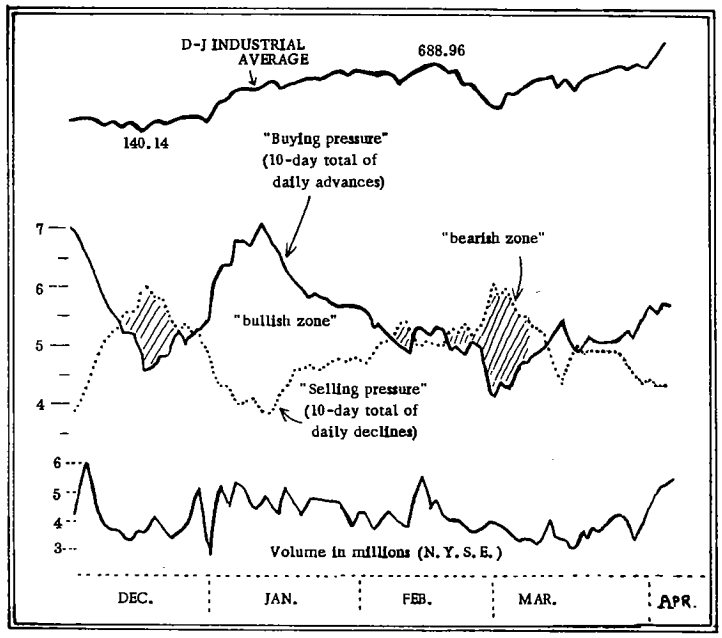


This bizarre and disturbing series of relationships will become increasingly important as (and if) Industrials advance for an attack on the 1961 all-time high of 734.91. In fact, John W. Schultz (partner in Wolf & Co., N.Y.C.) writes in the current issue of Forbes Magazine: "As a result of this conspicuous lag (in the A-D ratio), it is difficult to visualize how the A-D ratio could manage to follow the DJI to a new post-1961 peak promptly enough to avoid the kind of divergence between the two indicators that has, in the past, alerted analysts to the threat of serious downtrends. Major uptrends in the blue-chip Industrial Average have not survived repeated failure of the A-D ratio -- that is, the mass of the market -- to reach a new high of its own." Then Mr. Schultz adds that "... there might be some justification for hoping that the Industrial Average will fail to reach a new high over the near term."

But it all depends on whether you own stocks, when you bought them, and what side you're on. Dealing with the same idea, Editor A.W. Cohen of Chartcraft Service (Larchmont, New York) states in his current report: "All significant technical indicators remain bullish. How they can possibly be interpreted differently is beyond our understanding. Some bearish talk around is even getting silly -- for instance: it is not good for the DJIA to make new highs, especially if it makes new all-time highs. Why? You might get a triple divergence. This philosophy seems to say that since some time in the distant future we will have a new bear market, it is better for the market not to go up at all.'

As the old timers say: "Differences of opinion -- that's what makes markets."

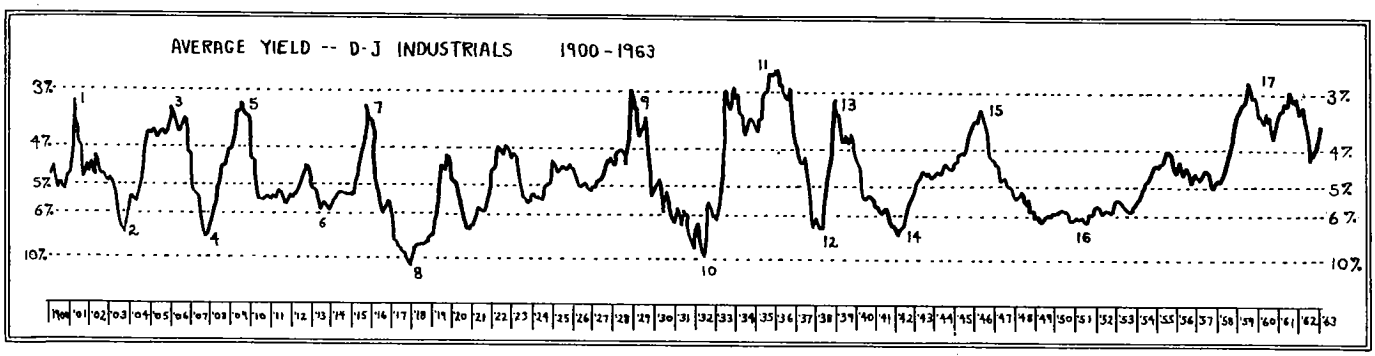
BUYING AND SELLING PRESSURE As noted in previous Letters, buying pressure assumed the dominant position on March 12. Since that time buying has held above selling, and towards last March (see graph) the two lines began to flare out -- with buying pressure gaining while selling pressure steadily declined. Buying has held above selling for almost twenty trading days, and as yet the buying pressure line is not in "overbought" territory (i.e. above 7,000 advances). This suggests that the stage is set for a further and perhaps important extention of the rise.



YIELDS Last week Moody's broad Average of 125 Industrial stocks provided a yield of 3.32%. The only lower yields in the history of Moody's Stock Average were one months in 1929 and one month in 1958. Last week the D-J Average of 30 "blue-chip" Industrial stocks afforded a yield of 3.31%. Thus, after moving (see chart) temporarily into the 4% yield zone during the 1962 "crash", average Industrial yields have again climbed into the 3-4% yield zone.

As discussed many times before in these Letters, the 3-4% yield zone is the zone of classic "over-valuation", or the area in which informed investors traditionally distribute their stocks. The accompanying chart shows, in fact, that since 1900 every major bear market decline has started from the over-valued 3-4% yield zone on the Industrial Average.

Time moves slowly for impatient investors, and it sometimes takes many years before a market movement can be properly appraised (from the unemotional perspective of history). The eight odd numbers on the accompanying chart (1 through 15) designate important stock market "tops". Peak number 17 commenced formation in late 1958, and from the appearance of the chart pattern one might conclude that the 1958-63 peak-yield pattern is still in the process of formation.



There have been no instances in the past when the market formed a base for a major and sustained move from the 4% yield level. During 1926-27 and again in 1957 the Industrial Average declined to a point where average yields touched approximately 5%, but the 1962 collapse appears (on the chart) to be part of a major top rather than a full correction and a return to values.

From January to May, 1929, the two Averages formed a narrow "line". During that period the average yield on Industrial fluctuated between 3.1 and 3.8%. In May, 1929, Industrials turned unexpectedly up, and the ensuing May to September advance carried Industrials from 293.42 to 381.17. Only one thing bespoke danger during that rise -- the absence of "values". At the 1929 highs, average Industrial yields dropped to the 3.3% level. Nevertheless, the situation at the time appeared technically strong. In fact, Hamilton, in Barron's (July 1, 1929) noted: "Both Averages have now made the highest recorded figures in their history. This is a definitely bullish indication, carrying the implication that the great bull market which has now ruled for four months short of six years has resumed its upward movement, with each Average confirming the other. The position indeed is technically one of peculiar strength, as a little analysis shows."

When the turn came two months later, it came suddenly and with little warning. Perhaps the most difficult thing to do in investing is to "see" the market as part of a great, continuing flow of history. Based on what we know of the past, when average yields drop into the 3 1/2% and lower area, the market is on shaky footing (from the standpoint of fundamental values). Those who have ignored or forgotten this have lived to regret it.

SUNDRY THOUGHTS AND COMMENTS The dramatic rallying action of April 3-5 brought in the highest market volume since mid-February. Such action obviously carries bullish implications. "But where is the public?" asks the veteran observer. Odd-lotters continue to sell; Barron's Low-Priced Stock Index scarcely budges (latest figure -- 181 against a 1959 peak of 250); and volume in both the low-priced stocks and on the speculative American Exchange remains low. If the Averages continue to push higher, it will be interesting to see whether the public will resist the clarion call of Wall Street. One thing can be said with certainty -- the market will not "boil" unless (or until) the public comes in again.

The actual record of the thirty D-J Industrial stocks over the last four years probably best dramatizes the reason for the average investor's confusion and frustration: (1) Between 1959 and 1960 the D-J Industrials lost 119 points. (2) Between 1960 and 1961 Industrials gained 169 points. (3) Between 1961 and 1962 Industrials lost 199 points. (4) Since June, 1962, Industrials have gained 167 points. Yet with it all, Industrials are now only a few percentage points above their 1959 peak, while Rails are still considerably below their own 1959 high. This type of wild, gyrating action is calculated alternately to excite and then scare investors. But finally it discourages them. Because many stocks and many groups have not participated in the latest advance, and because the action of the last four years has been so nerve-wracking, the average investor now finds himself watching with mixed emotions as the senior Average nears its 1961 all-time peak.

And even as the historic 1961 peak of 734.91 is approached, the sophisticated market student might well wince as he reads the latest thought in Humphry Neill's famed Letter of Contrary Opinion: "A fast rise into new highs for the stock market Averages would not only be a stunning surprise, it would also be the cause of much refiguring among investors.

"Therefore -- although a word of caution may be early -- I suggest that if the indexes rise to new highs, we may fail to stop, look and check our emotions! Little attention will be paid to the notion that, maybe, as in 1961, the stock market will be girding for a final spurt, instead of starting out on a nice, new bull market."

STOCKS Of 350 stocks which are tabulated for each issue of this Letter, 237 are now holding above their long-term (30-week) moving average (an increase of 1% from last week).

On a group relative strength basis, the Autos, Farm Equipment and Oils continue strongest while Aircraft, Electronics and Sulphers are now showing up as weakest. As mentioned so many times before, the "schizophrenic split" in the action of high-grade and secondary-grade issues is a prime factor to contend with in today's market. Thus the prudent investor is tempted to "buy the ones that go up easiest" (i.e., the blue-chips), while the more speculative-minded practitioner is tempted to "buy the bargains and wait".

Some of the strongest blue-chips now are International Harvester, General Motors, U. S. Plywood, Abbot Lab., Socony and Standard Oil of Indiana. Interesting speculations which could come to life are Cudahy Packing, Allis Chalmers (now acting well), Hupp, Brunswick, S. Amer. Gold and Platinum, Continental Motors.

The chart below shows the daily price action of that tarnished blue-chip, U. S. Steel. Old timers wonder how much longer the market rise can continue without taking U. S. Steel out of its current "depressed" range. Steel has been in a rather compact "line" of its own for many months. A rise above 50 would suggest that the current "supply" has been used up, and that Steel should be heading for higher areas.

The second chart shows the daily action of one of the components of Barron's Low-Priced Stock Index, Cudahy. Note the extraordinarily dull volume in this stock over the past year. Nevertheless, if Cudahy should break above 10 I would expect volume to increase markedly. Cudahy was 15 as recently as January of 1962. If the low-priced stocks are to "move", I would expect Cudahy to be one of the issues that leads the way.

Charts on this page courtesy of Traders Research, P. O. Box 2466, St. Louis 16, Missouri.